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No. 93-326

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1993

SECURITY PACIFIC AUTOMOTIVE FINANCIAL SERVICES CORP.,

Petitioner,

-v.-

BETTY LUNDQUIST, on behalf of herself and all others similarly situated,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MOTION FOR LEAVE TO FILE A BRIEF AMICUS CURIAE; and BRIEF OF AMICUS CURIAE NATIONAL VEHICLE LEASING ASSOCIATION IN SUPPORT OF THE PETITION OF SECURITY PACIFIC AUTOMOTIVE FINANCIAL SERVICES CORP. FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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MOTION OF NATIONAL VEHICLE LEASING ASSOCIATION FOR LEAVE TO FILE A BRIEF AMICUS CURIAE

The National Vehicle Leasing Association (the "Association") respectively moves this Court for leave to file a brief amicus curiae in support of the petition of Security Pacific Automobile Financial

Services Corp. ("Security Pacific") for a writ of certiorari in the above-captioned matter. The consent of Security Pacific has been obtained, and the consent of Respondent was requested, but refused.

The interest of the Association arises from the fact that the Association is a trade association representing members of the vehicle leasing industry, and industries providing services to the vehicle leasing industry, with in excess of 450 members located throughout the nation. The Association's members have leased in excess of 5,000,000 vehicles to individuals and businesses throughout the country. The Association's member lessors located within the Second Circuit will be negatively impacted if the opinion of the Second Circuit is not reversed. Accord-

ingly, the Association is vitally interested in this matter.

The Association, as a representative of a large segment of the vehicle leasing industry, is thoroughly familiar with leasing issues. It is the Association's intent in submitting a brief amicus curiae to address several matters which were not addressed by the Second Circuit in its decision. These issues relate both to what the Association believes was an incorrect application of the relevant law as well as the failure of the Second Circuit to consider the necessary ramifications of its decision.

Of particular relevance is the Second Circuit's apparent failure to consider the potential negative impact on consumers which this decision will create. As will be more fully explained in the brief, the

methodology of calculating lessee's early termination lease balance liability contained in the Security Pacific lease is eminently fair both to lessors and lessees. Any simpler format, which is what the panel may contemplate, will of necessity result in a formula which will have arbitrary results and presumably increase the overall liability of consumers, or alternatively, expose lessors to loss. Neither such result is mandated under the lease at issue.

For the above reasons, the Association respectively requests that this motion be granted and that the Association

be granted leave to file the following brief amicus curiae.

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INTRODUCTION, AND INTEREST OF THE ASSOCIATION

This amicus curiae brief is submitted on behalf of the National Vehicle Leasing Association (the "Association") in support of the petition of Security Pacific Automotive Financial Service Corp. ("Security Pacific") for a writ of certiorari to the United States Court of Appeals for the Second Circuit. The Association is a nationwide trade association with in excess of 450 members engaged in vehicle leasing and providing services to the vehicle leasing industry. The Association's members have leased in excess of 5,000,000 vehicles to consumers and businesses nationally, with the majority of those leases being to consumers. The Association is the only national trade association whose principal focus is the interests of vehicle lessors leasing to consumers.

This brief is directed to the portion of the Second Circuit decision relating to the language in the early termination provision of the Security Pacific lease which deals with the preservation of Security Pacific's "book position." Like the substantial majority of consumer vehicle leases, the Security Pacific lease provides that upon early termination the lessee is responsible for the sum of:

> (1) all past due payments and any other amounts due because of a default; plus
>
> (2) the lessor's book position in the lease; less
>
> (3) the amount realized through disposition of the vehicle.

And, as with the substantial majority of leases which calculate a lessee's early termination liability with reference to the lessor's book position, the book position is calculated with reference to that

portion of FASB 13 which relates to "direct financing leases." The language Security Pacific utilizes to describe the FASB 13 lease writedown methodology is fairly typical of leases of this type.

In reviewing the Security Pacific lease, the Second Circuit noted its agreement with the trial court that the "disclosures are not readily understandable" and went on to state that "the termination formula in Item 16(c) of the lease is a Byzantine formula, beyond the understanding of the average consumer." This wholly conclusory analysis leaves the lessor community in a complete quandary as to what may be permissible in the context of consumer vehicle leasing. Specifically, the Second Circuit decision could be read as saying that:

(1) The disclosures contained in paragraph 16 of the Security Pacific lease are inadequate,

(2) The actuarial writedown methodology contemplated was inappropriate, or

(3) Neither the disclosure nor an actuarial writedown are appropriate.

The Second Circuit decision gives lessors no guidance on how to fulfill their legal duties, and in light of the tremendous growth of consumer vehicle leasing and the pervasive usage of the FASB 13 writedown methodology, it is highly inappropriate that lessors should be forced to operate in the environment of uncertainty created by the Second Circuit decision.

The Second Circuit decision may rest on the proposition that disclosure of a lease writedown method (the mechanics of which the average consumer will not understand, whether or not adequately disclosed) violates the Consumer Leasing Act. If so, the decision runs directly contrary

to the clear trend of case law, the apparent thinking of the Federal Reserve Board, the clear language of Regulation M and the reality of an electronically-based financial world. The decision should be reviewed by this Court.

The Financial Accounting Standards Board Standard No. 13 ("FASB 13") writedown methodology (i.e., the method used in the lease for determining the lessee's depreciation credit for purposes of calculating the lessee's early termination liability) employed in the Security Pacific lease is an actuarial method writedown system employed in the substantial majority of consumer leases written nationally. The same considerations which have caused commentators to approve the actuarial writedown method, together with the provisions of Section 183(b) of the Consumer Leasing Act, 15 U.S.C. § 1667b(b) ("Section 183(b)") have led lessors to adopt

the FASB 13 system. Under the Second Circuit decision, it is impossible to ascertain whether the Court finds fault with the actuarial method (i.e., is that the "Byzantine formula?") or the means of its expression.

The uncertainty created by the Second Circuit decision may cause lessors to forsake the fairness of the FASB 13 actuarial-type methodology for a numerically-driven formula which will inevitably result in an early termination charge lacking the inherent fairness, from the perspective of either the lessor or lessee, of the actuarial writedown which by definition preserves the implicit yield in the transaction. This is clearly inappropriate from a policy perspective.

ARGUMENT

I. THE LEASE ADEQUATELY DESCRIBES THE WRITEDOWN METHODOLOGY UNDER CURRENT LAW.

Paragraph 8 of the Security Pacific lease, which describes the writedown methodology to be employed, reads as follows:

> 8. ALLOCATION OF MONTHLY LEASE PAYMENTS
>
> Portions of each monthly lease payment are for depreciation, lease charge and sales/use tax. While the total amount of each monthly lease payment will be the same (assuming that current sales/use tax rates, if applicable, do not change), the depreciation and lease charge portions will differ with each payment. During the lease term you will earn a total of lease charges equal to the product of the number of monthly lease payments, due under the lease times $\underline{\$102.24}$, the average monthly lease charge. The lease charges will be earned by you on a constant yield basis in relation to the Adjusted Lease Balance as it declines during the lease term. The lease charge portion for any monthly lease payment is figured by multiplying the rate which provides a constant yield throughout the lease term times the Adjusted

> Lease Balance. Again, the portion of the monthly payment not allocated to lease charges or sales/use tax will be allocated to depreciation. (These calculations will follow the rule for journal entries for lessors as to direct financing leases obtained in Statement of Financial Accounting Standards No. 13.)
>
> At any given time the Adjusted Lease Balance is:
>
> (a) $18,780.00 less (b) the sum of (1) all depreciation amounts received by you to date plus (2) One Base Payment, Item 3.A.

This disclosure tells the consumer two salient facts: first, that the writedown will be done in accordance with constant yield method as implemented by FASB-13; and second, how the writedown system works from a conceptual perspective. Absent are only the actual mathematical formulas, of which more will be mentioned below.

Regulation M requires disclosure of the "method of determining the amount of any . . . charge for early termination."

12 C.F.R. § 213.4(g)(10). The Security Pacific lease clearly states that FASB 13 will be the method used. The question then becomes whether reference to a method is adequate, or whether the "method" contemplated in 12 CFR § 213.4(g)(10) contemplates something other than an indication of the method, such as the specifics of the method, including its mathematical formula or formulae.

The Federal Reserve Board in addressing this issue in an analogous setting noted:

> Many state statutes provide for rebates of unearned finance under methods known as the "Rule of 78's" or "sum of the digits" or other methods. In view of the fact that such statutory provisions involve complex mathematical descriptions which generally cannot be condensed into simple, accurate statements, and which if repeated at length on disclosure forms could detract from other important disclosures, the requirement of rebate "identification" is satisfied simply by reference by name to

> the "Rule of 78's" or other method, as applicable.

Regulation Z Commentary § 226.818(c) (emphasis added). Although Regulation Z has been rescinded, Regulation Z was the predecessor to Regulation M and its logic is compelling and validates the reference to FASB 13 in the Security Pacific lease.

In fact, a reference to the Rule of 78's, another rebate method used by some lessors, was recently found adequate in Kedziora v. Citicorp National Services, Inc., 780 F.Supp. 516, 530 (N.D.Ill. 1991). The Kedziora decision is particularly instructive in part because of its analysis and in part because of the conceptual similarity of the facts there to the facts at hand.

The lease at issue in Kedziora provided that a Rule of 78's writedown methodology was to be employed in calculating the early termination lease balance. The

plaintiff argued, among other things, that "the disclosures of early termination liability are generally hard for the average consumer to understand" and that reference to a method alone was inadequate. Kedziora, 780 F.Supp. at 529-30. The court held that the disclosure was adequate under the law even if it was generally difficult for consumers to understand.

First, the court concluded that "more" was not necessarily "better:"

> There is no avoiding the fact that a lease must contain a lot of information, much of it technical, legal or mathematical. Not all such information can be conveyed in terse everyday language. Perhaps the Lease at issue here could be made clearer if it were made longer -- if every cross-reference were replaced by repetition of the matter covered, and if every significant term and contingency were spelled out in detail. But the Act certainly does not require the lessor to take such steps, and no doubt if the lessor did some plaintiffs' attorney would argue (with justifica-

> tion) that the lessor had burdened the consumer with "informational overload"....

Kedziora, 780 F.Supp. at 529.

Second, the court noted that the purpose of disclosures under the Act, which is to remedy abuses resulting from consumer ignorance of the nature of credit arrangements and to enable consumers to shop for credit by comparing uniform terms, would not be better satisfied if the lease had contained a description of the operation of the Rule of 78's or of the actuarial method. Such a description, the court said, would not put the consumer in a better position to shop for credit, and, in fact, "[w]hat might pass for technical full disclosure would in practice substitute obfuscation for the summary that is afforded to Citicorp's lessees." Kedziora, 780 F.Supp. at 530.

Finally, the court stated that Regulation M specifically permits disclosure of "methods or amounts." Id.

Essentially the Kedziora court concluded that the lessors should be allowed to utilize the same types of writedown methodologies as creditors and that a general description of the methodology employed was adequate, since a full-blown explanation was likely to be so confusing as to be meaningless. The Federal Reserve Board's explanation of the actuarial system as discussed below, is functionally identical to the FASB 13 writedown methodology. Given the contents of the explanation, it is clear how the Kedziora court might have reached its conclusion.

The plain language of Regulation M, the Federal Reserve Board Commentary and the Kedziora decision dictate that a reference to FASB 13, such as the reference found in paragraph 8 of the Security Pa-

cific lease, is adequate. The remainder of paragraph 8 of the Security Pacific lease falls into its proper context as additional information allowed to be included pursuant to 12 C.F.R. § 213.4(b). Focusing on the lessor's calculations and substituting $5,000 for the $18,870 figure and 1.003% for the appropriate level yield return applicable in Ms. Lundquist's lease, it is clear that this additional information correctly describes in generic terms how FASB 13 works without introducing the actual mathematics.

II. THE ACTUARIAL WRITEDOWN METHOD USED IN THE SECURITY PACIFIC LEASE IS FAIR WHETHER OR NOT IT IS READILY UNDERSTANDABLE BY THE AVERAGE CONSUMER.

The "byzantine" nature of an actuarial writedown method should not be an issue in a disclosure matter. Courts have long recognized that consumers may not understand how an actuarial or Rule of 78's

writedown method works, see, e.g., Kedziora, 780 F.Supp. 516, Drennan v. Security Pacific National Bank, 28 Cal.3d 764, 772, 170 Cal.Rptr. 904, 908 (1981), but have nevertheless upheld the disclosure where there is a reference to the method employed. In the case of consumer leases this is particularly appropriate because of the "safety net" effect of Section 183(b).

Section 183(b) requires that charges imposed in relation to a default or other early termination must be reasonable in light of the particular circumstances. The prohibition against the imposition of unreasonable charges is the "safety net" of Section 183(b). The constant yield or FASB 13 writedown, which is an actuarial type writedown method, clearly satisfies the requirement of Section 183(b) by protecting the implicit yield in the transac-

tion.[1] In fact, the constant yield approach is more than fair to consumers because the lessor's true yield will always be less than had the transaction gone to term and the lessor's set-up costs been fully amortized.

Expressed alternatively, if lessors are not to be foreclosed from usage of electronic means of establishing lessees' early termination liability which focus on return on investment, preservation of yield and the like, lessors must be allowed to disclose the lessee's liability with reference to an actuarial type (i.e., actuarial, United States Method, FASB 13)

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1 The implicit yield is the simple interest return on investment the lessor would receive if the lease went to full term, all payments were timely made and the lessor recovered the lessor's estimated residual assumption at lease end. FASB 13 results in the same return at early termination. This is not to say that other approaches may not also satisfy Section 183(b) in the context of the particular lease.

or other writedown method. It must then be taken as a given that some consumers will not understand the precise calculation and that a full-blown disclosure of how it works will do nothing to advance that understanding and will probably cause claims of "informational overload" in violation of the Supreme Court's mandate in Ford Motor Credit Co. v. Milhollin 444 U.S. 555, 568 (1980). See also Kedziora, 780 F. Supp. at 529. Section 183(b) performs the remedial function of allowing current financial reality to operate in a fashion which protects the legitimate and substantive interests of all concerned.

The alternative is to require lessors to specify mathematical formulas in their leases. This approach is potentially unfair to one party or the other, will encourage significant Section 183(b) litigation, will require lessors to maintain separate lease accounting and lessee bal-

ance systems and will not enhance substantially the meaningfulness of lease disclosures. Adoption of this approach also leads to the conclusion that Congress intended that the use of modern financial systems be restricted to creditors, and not to lessors. It is inconceivable that Congress anticipated such a result when passing the Consumer Leasing Act.

III. THE SECOND CIRCUIT DECISION HAS CAUSED CONFUSION IN THE LEASING COMMUNITY.

As noted above, in its decision the Second Circuit fails to indicate whether the concern is with the disclosure, and if so, in what regard, or with the fact that the Security Pacific lease uses a formula a consumer may not readily understand. Given the tremendous growth of consumer vehicle leasing, the fairness of the FASB-13 actuarial writedown method and the pervasive usage in the industry of that

writedown methodology, allowing the the Second Circuit decision to stand would disserve lessors and lessees alike. The current summary language in the Second Circuit decision could lead the industry away from a writedown approach which so clearly fosters the legitimate expectations of lessees (and, in fact, as noted above, goes beyond mere equality).

FASB 13 leases have for many years provided lessors a comfort level that their Section 183(b) duties were being fulfilled. Further, lessors have, as have creditors, assumed that reference to the methodology of writedown would be adequate. The leasing industry should not be so cavalierly dissuaded from those assumptions.

In a real sense the Second Circuit was faced with the following policy decisions:

> (1) Consumers may not as a practical matter comprehend writedown or amortization methods that are used in the financial services industry. Does that mean that lessors cannot legally use those methods?
>
> (2) If lessors can use those methods, what forms of disclosure are adequate?

Unfortunately, in dealing with these questions the Second Circuit appears to have ignored the significant body of law which has dealt with the issues before it. The Second Circuit has also failed to explain its holding in a manner which will instruct those seeking to follow its dictates in any meaningful way. This Court should not allow that ambiguity to continue.

CONCLUSION

The Association believes the Second Circuit decision was incorrect from both a legal and policy perspective and should be reversed. However, regardless whether or not the Second Circuit decision was correct, it is clear that the Second Circuit's decision must be clarified. The petition should be granted.

Respectfully submitted,

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